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OFFICE OF THE SECRETARY

Keith L. Seat
Senior Counsel
Federal Law and Public Policy

1133 19th Street, NW
Washington, DC 20036
202 887 2993
Fax 202 736 6492

May 16, 2002

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Via Hand Delivery

EX PARTE OR LATE FILED

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: EX PARTE – WC Docket No. 02-67: Application by Verizon for Authorization to Provide In-Region InterLATA Services in New Jersey

Dear Ms. Dortch:

Enclosed is a WorldCom memorandum on benchmarking and pricing issues in the above proceeding which contains confidential information. A confidential version and a redacted version are being submitted with appropriate cover letters with the understanding that the confidential material will be fully protected by the Protective Order established specifically for this docket and that the requirements for review and use of this document will be fully satisfied.

Please call me with any questions.

Sincerely,

Keith L. Seat

Keith L. Seat

Enclosure

cc (w/encl.): Susan Pié, Anthony Centrella (NJPUC), Laura Starling (DOJ)
Ann Berkowitz (VZ), Qualex International

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"Benchmarking" and TELRIC Issues in New Jersey

This memorandum discusses the methodology that should be used to perform a benchmark analysis for comparing unbundled network element ("UNE") rates across states, as requested by Commission staff in the pending New Jersey section 271 docket, WC 02-67. In addition, it responds to claims set forth in Verizon's reply comments of April 19, 2002 in docket 02-67 regarding its methodology for annualizing busy hour minutes of use, which significantly affects the switch usage rate as set forth in WorldCom's comments.

I. Benchmarking Methodology

WorldCom continues to object to any application of "benchmarking" that would approve UNE rates infected by serious, known TELRIC errors. But the benchmarking concept is even worse if it provides a distorted picture, as it does as presented by Verizon in this case. Verizon compares New York non-loop rates at New York volumes to New Jersey non-loop rates at New Jersey volumes. This is improper for two reasons. First, it ignores the requirement in section 252(d) of the 1996 Telecommunications Act that the rates for network elements be based on the cost of providing the network element. The Act explicitly requires that each individual element be set at a level that reflects the costs of that element. By mixing together several elements – in this case, switching, transport, and signaling – Verizon's methodology would allow it, for example, to mask an excessive rate for switching with a low rate for transport.[1] Second, by using different volumes for the different states, Verizon's methodology cannot identify whether the differences are due to differences in the rates or differences in the volumes.

Analysis of Verizon's practice of comparing different numbers of minutes in different states reveals errors in Verizon's approach. It is a commonly accepted practice to use a fixed market basket of goods to determine the average change in the prices of those goods. This is the methodology used by the Bureau of Labor Statistics to compute the Consumer Price Index. It is also the methodology that the Commission itself adopted to compute its Actual Price Index, which measures the average change in the price of access in the price cap plan. Use of a fixed market basket will separately identify the changes that are due to changes in the price. If changes in the quantities purchased were used to compute a price index, the index could change even if the prices themselves were no different. To use a simple example, assume there are 100 units of two goods sold at $1 per unit for both goods, yielding a total cost of $200. Now suppose that in the next

[1] This error is compounded even further in Verizon's effort to compare the rates of combined loop and non-loop elements between the two states. WorldCom has already fully explained the legal basis for why switching rates must be considered separate from other UNEs. Verizon has not responded, so we rest on our previous analysis.

time period, the prices of both goods double to $2, but only 50 units of each good are sold, yielding a total cost of $200. Under Verizon's methodology, these data would show no change in the price, even though the prices both doubled. The apparent lack of difference in the rates is simply an artifact of the different demand levels, rather than a result of any real similarity in the rates between the two time periods.

One possible defense of Verizon's methodology is that the relative costs to which the relative rates are being compared are per-line costs. This implies that although the rate structure used to recover these costs is a combination of per-minute and per-line rates, the correct comparison should be to the total per-line cost, computed at average usage of lines and minutes. However, this argument begs the question – it merely *assumes* that the correct characterization of the costs is on a per-line basis. If this is the case, then cost-causative rates should also be only per-line. Verizon cannot divide up cost recovery into per-line and per-minute rates, and then claim that the costs are really per-line and that the weighted sum of these rates should tie to the per-line cost. Either the costs of these UNEs are per-line, in which case rates should be set on that basis with no usage component at all, or the costs vary by both minutes and lines, and the weighted average of those two types of rates should be consistent across states for purposes of benchmarking, when evaluated at a constant set of demands.

By dividing recovery of switching costs into per-minute and per-line elements, Verizon has implicitly claimed that the costs of switching change as minutes and lines change. Given this, it is not true that the switch rates have to recover a fixed per-line amount, so that lower minutes per-line would justify a higher per-minute rate.[2] Instead, lower minutes per line imply a lower total cost of the switch, and thus a lower per-line cost. This being so, a fixed basket of line and minute demand levels should be applied to rates in the two states being compared to determine whether a state meets the benchmark comparison.

II. Busy Hour Annualization

In its reply comments, Verizon again attempts to explain the inexplicable – how multiplying business day usage by only the 251 business days in the year can yield a reasonable estimate of annual switch usage on business days, weekends and holidays. Verizon's explanation is premised on the assumption that the number of minutes of use during the "busy hour" it uses to size its switches is significantly greater than the number of minutes in an average busy hour. While it is obviously true that there will be variation in the number of minutes of use in the busy hour on different days, Verizon has presented no evidence, in this proceeding or in the state proceeding, that the business days from which it claims to have derived its busy hour minutes of use had busier than average busy hours.

[2] Even assuming, *arguendo*, it were true that lower minutes would justify a higher per-minute rate, it does not follow nor has Verizon proven that, for example, a 10 percent decrease in the number of minutes should properly result in a 10 percent higher per-minute rate.

Verizon states that in New Jersey it sized its switches "to meet service levels for the average demand in its *busy hour* during its *busy season*". See Garzillo/Prosini Supplemental Reply Declaration at ¶ 31 (emphasis in original). Verizon goes on to state that the busy hour is defined as the hour during the business days of the week in which the switch experiences the highest average demand, and that the "busy season" is the three non-contiguous months of the year that experience the highest average demand.[3] Id.

Verizon has presented no proof that this average busy day minutes of use count represents a particularly busy business day. Because the busy hour minutes are an average of the results from the busy hour on the days of three different months, it is likely that they are closer to an average of the busy hour for the year. In addition, Verizon provides no proof that the "busy season" months it used have busy hours that are busier than the busy hours in the other months. It is possible that the "busy season" months have higher than average usage because their *weekends* are busier than the other months. If that were the case, the busy hour usage in the "busy months" could even be *less* than the average busy hour usage for the entire year.

Even if the busy hour minutes Verizon estimates from these three months were higher than the annual average busy hour minutes, Verizon has presented no data that supports its claim that using only the 251 business days to annualize demand captures this difference. Verizon *has* measured weekend and holiday usage and calculated that, compared to average business day usage levels, there are *** *** "business-equivalent days".[4] This being the case, use of the 251 business days would offset the supposed difference between the busy hour minutes used by Verizon and the annual average busy hour minutes only if the busy hour minutes used by Verizon were *** ***/251 times, or *** *** percent higher than average busy hour minutes. Verizon has presented no evidence that this is the case. In fact, the only data Verizon does present for busy day usage is the data it uses to compute the busy hour to day ratio from the months of March 1998, June 1998, November 1998, and March 1999.[5] These data show that the monthly variation in busy hour to business day usage is no more than 3.3 percent. Given this, it is impossible to believe – and Verizon certainly has not demonstrated – that there is a *** *** percent difference in the busy hour to business day usage ratio between the months it used for its busy hour data and the ratio over the entire year.

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[3] This methodology stands in marked contrast to the methodology in Vermont, where Verizon claimed to use the minutes of use from a single day in March to determine its busy hour traffic. By contrast, the busy hour minutes of use in New Jersey already represents an average across several business days in several months.

[4] WorldCom noted this fact in its comments at page 6. *See also* Frentrup Declaration at ¶ 8. This calculation was presented with Verizon's computation of its transport rates. In the Garzillo/Anglin/Prosini Supplemental Reply Declaration filed with its Reply Comments, Verizon acknowledged (at ¶ 37) that this number of business equivalent days would apply to average business day usage.

[5] These data are provided in the workbook usage122001.xls, provided by Verizon in its January 25, 2002 ex parte in CC Docket 01-347. The data can be found in sheet '4.4 BH Ratio' of that workbook. In the Garzillo/Anglin/Prosini Supplemental Reply Declaration, Verizon states (at ¶ 32) that the data was from September 1998 rather than June 1998.

Verizon's assertion that obtaining annual usage by multiplying busy day usage by 251 days is reasonable is thus indefensible. It is rendered even more so by the fact that Verizon has used the same 251 days in every one of its states. Could the ratio of minutes in the busy hour used by Verizon to minutes in the annual average busy hour be such *in every state* as to offset exactly the use of 251 business days? It is far more plausible that Verizon has simply chosen to multiply the busy day minute of use number by the number of business days. Verizon's claim that use of 251 business days to annualize busy day demand *might* yield the right answer appears to be an *ex post* rationalization rather than an *ex ante* reasoned approach. More to the point, Verizon's methodology surely will not yield the right answer because it implies a much greater variability in busy hour minutes than is supported by the record.

Verizon attempts to defend its use of this methodology for annualizing busy hour minutes of use by claiming that the Commission has already accepted the use of the same methodology in the context of its Vermont section 271 approval. However, Verizon fails to note that the Commission explicitly stated in that approval that the record "creates some question regarding Verizon's practice," and that it might "reach a different conclusion based on different evidence in a different section 271 proceeding." See Vermont 271 Order ¶ 31, n. 103.[6] As WorldCom has demonstrated *supra*, the state record and facts are markedly different in the New Jersey proceeding than in the Vermont proceeding. In fact, this issue is still before the New Jersey Board of Public Utilities in petitions for reconsideration. The Commission should reject the use of 251 business days to annualize demand in the context of the New Jersey state record, and reject Verizon's section 271 application until Verizon modifies its switching rates to correct this serious error.

In short, Verizon cannot overcome the serious TELRIC errors in its switching rates, and cannot succeed with its benchmarking case unless it can win the argument it should compare different levels of minutes in New Jersey and New York *and* the argument that actual CLEC levels of residential minutes should be rejected in favor of its indeterminate mix of usage *and* the argument that rates for switching can be ignored in favor of adding other UNEs into the comparison. Far from Verizon establishing all of these points as it must to successfully benchmark its switching rates, we believe that Verizon cannot prevail on any of them.

* * * * *

[6] See Application by Verizon New England Inc., Bell Atlantic Communications, Inc. (d/ b/a Verizon Long Distance), NYNEX Long Distance Company (d/ b/a Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization To Provide In-Region, InterLATA Services in Vermont, CC Docket 02-7, Memorandum Opinion & Order, FCC 02-118, (rel. April 17, 2002) ("Vermont 271 Order").

Please do not hesitate to contact us with any questions about this matter.

Chris Frentrup
Keith Seat

May 16, 2002